

# Agricultural Trade and the U.S. Economy

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## Introduction

As U.S. government support to agriculture declines, understanding the economic impacts of agricultural trade and how markets and competition are affected will take on added importance for farmers, agribusinesses, policy makers, and agricultural leaders. With a 1996 Gross Domestic Product (GDP) of \$7.6 trillion and a per capita GDP of \$28,700, the United States is the world's largest economy and a major market for both domestic and foreign producers of goods and services. In 1996, U.S. exports totaled \$582 billion (7.7% of GDP) while U.S. imports totaled \$790 billion (10.4% of GDP). International trade accounted for 18 percent of U.S. GDP in 1996 compared to 12 percent in 1994. In fact, the United States is now more dependent on international trade than at any time since 1880-1914 when 16 percent of GDP was generated by merchandise trade. Major export commodities include: capital goods, automobiles, industrial supplies and raw materials, consumer goods, and agricultural products.

While agriculture accounts for 2% of U.S. GDP and 2.8% of the labor force, it represents 10.4% of total exports (\$60.4 billion), 4.3% of total imports (\$33.6 billion), and generated a \$26.8 billion trade surplus in 1996.

Agricultural trade contributes employment, income, and economic activity to the U.S. economy. Estimated trade-impact multipliers for 1996 indicate that to produce one million dollars of agricultural exports required 15 workers. Each dollar of agricultural export sales generated an additional \$1.32 of economic activity. Agricultural exports required the employment of 859,000 workers and generated \$140 billion in business activity (Edmondson).

Imports also generate jobs and create economic activity. Leading imports include: crude oil and refined petroleum products, machinery, automobiles, consumer goods, industrial raw materials, and food and beverages.

Despite the contributions of international trade, some still believe that the U.S. should not participate in an open international trading system. Calls for increased protection and isolationism are heard in some quarters.

Reverting to a closed economy is not economically rational in today's global marketplace. The notion of "made in America" has become a myth, with "assembled in" becoming a more appropriate term (Reich).

Trade policies are a mix of economics and politics, and much of the public information about the potential impacts of these policies comes through news media, which tends to focus on negative issues. The complexities surrounding the economic impacts of trade are often improperly perceived, or viewed from a narrow perspective.

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## Why There is International Trade

By its very name, international trade is perceived as something different than merely doing business with firms in other countries. Discussions in the media about trade policies, or attempts to settle trade disputes, cause international trade to be perceived as us versus them, where one country gains only if another country loses. In fact, international trade is not fundamentally different from the inter-regional trade among states in the U.S. Perceptions about international trade persist, partly because the losses from trade are concentrated and often highly publicized, while the gains from trade are less visible and are spread broadly, going virtually unnoticed. Such perceptions also persist because economists have not done a particularly good job of explaining why international trade exists, and what benefits it conveys.

One way to understand why trade occurs and what benefits it brings, is that nations do not engage in international trade, but rather the individual consumers and businesses within nations do. When an individual in the U.S. buys a Japanese-manufactured stereo component, he or she has engaged in international trade. This participation occurs indirectly through the power of consumer preferences and the competitive pressure faced by the retailers to satisfy them. When a manufacturing firm buys some of its inputs from foreign sources, it also engages in international trade.

Over two hundred years ago, Adam Smith in *An Inquiry Into the Nature and Causes of the Wealth of Nations*, argued that competition in combination with individuals freely pursuing their own self interest, or profit motive for businesses and the pursuit of satisfaction by consumers, would result in the efficient use of economic resources, allowing society as a whole to achieve its highest standard of living "as if guided by an Invisible Hand." Unfettered competition has its drawbacks. However, the power of competition and individual choice are the core of American economic philosophy and the primary forces that have enabled U.S. citizens to achieve a high standard of living. Competition and individual choice are also why there is international trade.

With rare exceptions, consumers are faced with incomes that constrain the amount of material goods and services they can buy. To satisfy their individual needs, consumers attempt to obtain the products they want most, at the best price. When purchasing a television, attention is primarily given to product quality, reliability,

and price, not where the product was made. When purchasing clothing, characteristics, such as fit, style, perhaps the designer's or manufacturer's name, and of course price, are much more important than where the product was made. And if consumers want cantaloupe in December, they are more interested in its taste and price than in where it was grown.

Evidence supporting the minor role that country of origin plays in purchase decisions abounds. While brand names and prices are prominently displayed in any retail store, one is not likely to see information on country of origin prominently displayed. The reason for this is simply that retailers provide consumers with the information they want in making purchase decisions, and this information does not generally include country of origin. Yet when decisions based on such information are made, and the goods or services purchased are foreign-made, consumers have participated in international trade.

Even if consumers wished to buy American, it would be difficult to accomplish.

*"Of the \$10,000 paid to GM, about \$3,000 goes to South Korea for routine labor and assembly operations, \$1,850 to Japan for advanced components, \$700 to Germany for styling and design engineering, \$400 to Taiwan, Singapore and Japan for small components, \$250 to Britain for advertising and marketing, and about \$50 to Ireland and Barbados for data processing. The rest—less than \$4,000—goes to strategists in Detroit, lawyers and bankers in New York, lobbyists in Washington, insurance and health care workers all over the country and to General Motors stockholders all over the world." (Reich).*

This example also explains why there is trade from the perspective of producers. Faced with the realities of the market place, and the consumer's demand for quality at the lowest price, the competitive pressures of rival firms force businesses to pursue cost-efficient business strategies. While such strategies entail many facets of production engineering and management organization, they also entail obtaining factors of production and other business- and marketing-related services at the lowest possible cost. When assembly by, or materials from, foreign firms or subsidiaries are cheaper, businesses have no choice but to pursue these lower-cost opportunities. Competition from rival firms, domestic and foreign, make such decisions necessary for businesses if they are to meet market demands and survive.

## **The Fallacy of Lost Jobs**

Few issues have commanded more media attention, or created more debate, than the impact of international trade on American jobs. At the heart of this debate is the perception that liberalizing trade with developing countries, such as Mexico, Central America, or Asia leads to the loss of American jobs, particularly in labor-intensive industries, such as clothing, manufacturing assembly, and labor-intensive agricultural products such as fresh fruits and vegetables. To a certain extent, the perceptions that jobs in certain industries are likely to be eliminated because of trade liberalization are true. However, these perceptions fail to distinguish between the general level of employment in the economy and employment in specific industries. Growing out of these incomplete perceptions is the “lost jobs fallacy” of international trade.

Protective trade measures, such as tariffs, quotas, or voluntary export restraints (VERs), designed to protect domestic jobs, are not without cost. Kreinin estimated that the VER placed on Japanese automobiles in 1982 saved approximately 22,000 jobs in the U.S. with an average salary of \$30,000. However, the cost to U.S. taxpayers for each job saved was estimated to be \$180,000. Thus, there was an actual social cost (net or deadweight loss) to the U.S. economy of roughly \$150,000 per job saved.

Two important points need to be made. First, because there is an additional transfer of resources from the rest of the U.S. economy to a particular industry in order to save specific jobs, there will be fewer jobs created in other sectors, and perhaps even some jobs eliminated. Second, from a government policy perspective, even if the automobile industry was not protected, up to \$150,000 per worker could be spent on job search and retraining before reaching the cost of job protection. If such retraining and relocation could be done for less, a net economic gain would be realized relative to the cost of protection.

Protection also implies less trade, therefore less exports and fewer jobs in the trade sector. Trade liberalization leads to increases in imports in certain sectors of the economy and increases in exports in other areas. Again, these increases in exports create jobs.

U.S. employment in export-related activities is significant. There were 7.2 million export-related jobs in the U.S., accounting for about 7% of the total work force in 1990. Within the manufacturing sector, 17% of total employment is related to export activities and these jobs earn

approximately 17% more than similar non-export-related activities (Aguilar). Comparable figures are available for the agricultural sector.

There are two key elements of the “lost jobs fallacy.” The first suggests that liberalized trade leads to a loss of domestic jobs. In fact, the exact opposite can be true. Trade liberalization can lead to increased domestic employment. It is important to distinguish between the loss of specific jobs and the general level of employment. Trade liberalization can result in the elimination of jobs in specific sectors of the economy, as those who are potentially affected will quickly point out. In the short run, it is possible that job losses in labor-intensive sectors may not be offset by gains in capital-intensive sectors, thus creating increased structural unemployment. However, those who lose their jobs will find employment elsewhere; if they so desire, and if they are willing to re-train.

The second element is the belief that jobs can be saved through government protection. Governments can save specific jobs, however, the cost of doing so can be substantial. As the previous example demonstrated, the cost of a job saved may be many times the income it earns. This net loss to the economy may prevent the creation of employment and possibly lead to the elimination of other jobs.

## **The Perception of America's Lost Industrial Competitiveness**

Recent concerns over America's ability to compete in the international market place and fears of a decline in the country's industrial base have surfaced. Indeed, some leaders have warned of a future of hamburger flipping and sweeping floors in foreign-owned manufacturing plants, and President Clinton's administration has advocated the need for an industrial policy to ensure key U.S. industries remain competitive.

As a trip to any shopping mall demonstrates, a vast number of consumer products carry foreign names, such as Mitsubishi, Sony, or Panasonic, or microscopic print notes that it was made in some Asian or Latin American country. And even when a product carries an American brand name, such as RCA or Levi's, it is still often manufactured in a foreign country. So the apparent loss of America's industrial base takes on considerable credibility. However, as is the case with the fallacy of lost jobs, the issue of America's lost industrial base is a matter of perception rather than reality.

Recent data indicate that the perception of America losing its industrial base is incorrect



(Lindsey). During the 1960s, the U.S. was considered by most to be the industrial giant of the world. At this time, manufacturing accounted for about 22% of real gross domestic product (GDP), with the majority of this output in defense and consumer related products. Capital goods—items used to produce other goods and services, such as airplanes and industrial machinery—accounted for roughly 28% of GDP. Moreover, only 20% of capital goods were exported, amounting to 1.4% of GDP. Currently, and amid concerns about America losing its industrial base, manufacturing output has increased to 23% of real GDP. More importantly, capital goods now account for 38% of manufacturing output, and the proportion of capital goods exported has increased to 45%, amounting to about 4% of GDP.

America is strengthening its industrial base as a result of liberalized trade. What has changed is the composition of the manufacturing sector's output. The manufacturing share of U.S. consumer goods has declined, being supplanted by capital goods. Along with this change in manufacturing output, the industrial base of the U.S. has become less visible. In terms of comparative advantage, the U.S. appears to have an advantage in the production of intermediate goods and capital goods relative to some labor-intensive consumer goods.

## Conclusions

The U.S. is fortunate in that its climate, natural resource endowments, and technological knowledge potentially enable it to produce all of the products needed without trade. However, without trade, it is doubtful the U.S. would enjoy the standard of living it does. From a regional perspective, maple trees could be grown to produce maple syrup in Florida, and orange trees could be grown in Vermont to produce orange juice. Floridians would pay a lot more for maple syrup and the citizens of Vermont for orange juice. However, the fact is

that Florida is better at producing orange juice and Vermont is better at producing maple syrup, and by doing what each does best, the producer, the consumer, and the economy benefits from more efficient utilization of resources and lower prices.

International trade enables countries to specialize in what they do best and acquire the things they have difficulty in producing. By so doing, resources are more efficiently used on a global, as well as a domestic basis, and these efficiencies are passed on in the form of lower prices and economic growth.

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